Supreme Court, U. S.
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No. 80-19

IN THE

Supreme Court of the United States

October Term, 1980

HARRY LEWIS AND SYLVIA BAKER,

Petitioners,

vs.

WILLIAM H. ANDERSON, S. CLARK BEISE, SHIRLEY T. BLACK, ROY E. DISNEY, RONALD W. MILLER, RICHARD T. MORROW, DONN B. TATUM, E. CARDON WALKER, RAYMOND L. WATSON, WALT DISNEY PRODUCTIONS, GEORGE L. BAGNALL and GORDON E. YOUNGMAN,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

RESPONDENT'S BRIEF IN OPPOSITION.

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RESPONDENT'S BRIEF IN OPPOSITION.

Respondent, Walt Disney Productions (hereinafter referred to as "Disney") respectfully requests that this Court deny the petition for a writ of certiorari. Petitioners have presented no grounds for a review by this Court of the Ninth Circuit's interlocutory decision in this matter.

The petition should be denied for the following reasons:

1. There is no conflict among the Circuits on the issue presented herein. The decision of the Ninth Circuit is fully

consistent with the decisions of the Second and Eighth Circuits cited by petitioners.

2. There is no conflict between the decision of the Ninth Circuit and any decision of this Court.

3. The Ninth Circuit's decision was interlocutory, and directed a remand for further proceedings. Petitioners have cited no basis for this Court to intervene at this stage of the proceedings herein.

Question Presented.

Whether under *Burks v. Lasker*, 441 U.S. 471 (1979), an independent committee of the disinterested members of a corporation's board of directors may exercise its business judgment by determining that a shareholder's derivative suit alleging violations of §§ 10(b) and 14(a) of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78(j)(b) and 78(n)(a)), is not in the corporation's best interests and by seeking dismissal of such derivative action.

Statement of the Case.

Disney adopts, for purposes of this response, petitioners' statement of the case insofar as that statement relates to the procedural background of this suit.[1] Disney does not, however, adopt petitioners' description of the decision of the Ninth Circuit.

That Court, in *Lewis v. Anderson*, 615 F. 2d 778 (1979), upheld the decision of the District Court, Irving Hill, J.,

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[1]Although Disney believes that petitioners' statement of the case is not fully accurate, such inaccuracies or omissions as are relevant will be corrected in the course of the argument below. In addition, the Court should not be misled by the petitioners' assertion (Petition at 3) that "the prime beneficiaries of the alleged wrongful acts were the inside directors." As the record herein amply demonstrates, the officer-director defendants were only six of the more than 1,200 employees to whom the options in question in this case were issued, and the options granted to them represented only 9% of the options so granted.

to grant a partial summary judgment in favor of Disney. The Ninth Circuit held that California law requires the dismissal of a derivative action following a good faith decision to seek dismissal by an independent committee of the board of directors, and that such a result is consistent with federal policy as reflected in §§ 10(b) and 14(a) of the Securities Exchange Act of 1934. The decision as to the independence and good faith of the Disney litigation committee was reserved for trial in the District Court.

In its decision, the Ninth Circuit discussed and applied this Court's decision in *Burks v. Lasker* permitting independent disinterested members of a corporate board to exercise their business judgment by seeking dismissal of pending derivative litigation if such dismissal is permitted by the relevant state law and does not conflict with the policy of the federal statute involved. In accordance with *Burks*, the Ninth Circuit held that the application of the business judgment rule in this case did not contravene the federal policies expressed in §§ 10(b) and 14(a). Accordingly, the case was ordered remanded to the District Court for trial of the factual issue of good faith and independence.

REASONS FOR DENYING THE WRIT.

1. The Decision of the Circuit Court Creates No Conflict Among the Circuits.

Petitioners assert that the Ninth Circuit's decision is at odds with the decision of the Eighth Circuit in *Abbey v. Control Data Corp.*, 603 F. 2d 724 (8th Cir. 1979), *cert. denied* 100 S. Ct. 670 (1980), and the decision of the Second Circuit in *Galef v. Alexander*, 615 F. 2d 51 (2d Cir. 1980). Petitioners apparently base this assertion on their belief that the Ninth Circuit did not adequately analyze the underlying securities law claims as required by this Court's decision in *Burks v. Lasker, supra*. However, an examination of the cases shows clearly that there is no conflict.

Burks v. Lasker approved of the procedures followed in this case, provided that such action was proper under state law and contravened no important federal policy. Since *Burks* was decided, several circuit and district courts have been called upon to apply those principles to differing factual situations. As is to be expected, different factual situations require the courts to emphasize different elements in their analyses. Petitioners seize upon such immaterial differences in approach among these courts in an attempt to manufacture a conflict where none exists. Normal case-by-case development of the principles espoused in *Burks* does not, however, require a grant of certiorari by this Court, particularly when the lower courts, including the Ninth Circuit herein, have been steadfast in their application of the central principles of *Burks*.

A. Abbey v. Control Data Corp.

In *Abbey*, the Eighth Circuit held that a claim under § 14(a) of the Securities Exchange Act, 15 U.S.C. § 78(n) (1971), could be dismissed by an independent committee of directors authorized to dismiss derivative litigation under

state law. The *Abbey* court did observe that the § 14(a) claim was weak on the merits, and therefore that it saw no reason to assert the policies of the federal statute. 603 F. 2d at 730-32. The Court nowhere stated or implied, however, that it would not have permitted dismissal if the claims had not been weak. In fact, the district court decision authorizing dismissal, which was affirmed by the Eighth Circuit's opinion, relied on other factors, in particular the precedent in the Eighth Circuit permitting the exercise of business judgment to forego a possible corporate claim under the antitrust laws, and the fact that the federal policy expressed in the statute underlying such antitrust claims is at least as strong as that underlying possible claims pursuant to the securities laws. *Abbey v. Control Data Corp.*, 460 F. Supp. 1242, 1245 (D. Minn. 1978).

Petitioners concede that *Abbey* did not determine that the dismissal of a non-frivolous derivative action alleging § 14(a) violations would be inconsistent with the underlying federal policies, as the court was not presented with that issue. (Petition at 13-14.) Thus, the Ninth Circuit's decision below cannot conflict with the decision of the Court of Appeals in *Abbey*.

B. Galef v. Alexander.

In *Galef v. Alexander*, the Second Circuit expressly declined to decide the issue which the Ninth Circuit decided below. The *Galef* court did not permit dismissal because the directors who made the decision to seek dismissal of the action were themselves defendants. In sharp contrast, in this case, an independent committee of directors, authorized by state law, was the decision-making body.[2] Not only are

[2]Petitioners attempt to blur this factual distinction by asserting, in their statement of the case (Petition at 4), that their proxy claims arise out of both the 1973 and 1977 proxy statements. They allege, in a

(footnote continued on following page)

Galef and this case different on their governing facts, but, as petitioners themselves cite, the Second Circuit explicitly stated that it was not deciding the question "as to whether a state law interpretation permitting non-defendant directors, or a duly appointed committee of disinterested non-directors, to initiate a business judgment dismissal of § 14(a) claims would contravene federal policy." 615 F. 2d at 64, n. 20. (Petition at 15.) In declining to rule on that point, the *Galef* court noted that the Ninth Circuit had made such a decision, citing the opinion below.

In a subsequent federal case, *Maldonado v. Flynn*, 485 F. Supp. 274 (S.D.N.Y. 1980), the district court, interpreting *Galef*, did decide this issue which had been left undecided by the Second Circuit. Citing the decision below in *Lewis v. Anderson* with approval, Judge Weinfeld held that a committee of disinterested directors could exercise its business judgment by securing dismissal of a non-frivolous derivative action asserting § 14(a) claims.[3]

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footnoted argument (Petition at 4), that their claims as to the 1977 proxy statement render the exercise of business judgment by the Special Litigation Committee void. The Ninth Circuit, however, did not decide any claims with respect to the 1977 proxy statement. Indeed, the amended complaint in this action was served on July 1, 1976, prior to the issuance of the 1977 proxy statement in January 1977, and was never amended subsequent to the issuance of that proxy statement.

[3]Petitioners cite a state trial court action, *Maldonado v. Flynn*, 413 A. 2d 1251 (Del. Ch. 1980), decided after Judge Weinfeld's decision. The Delaware state court held that Delaware law does not permit directors to enter such a dismissal. Petitioners fail to advise the Court, however, that a subsequent decision by the Delaware court mooted the decision on which they rely on the grounds that Judge Weinfeld's prior decision was *res judicata* as to that issue. *Maldonado v. Flynn*, No. 4800 (Del. Ch. May 29, 1980).

In any event, Delaware law is not relevant to the present case. *Burks* held that state law governs this question. Disney is a California corporation, and the actions of its directors are governed by California law. As both the District and the Circuit Courts recognized, California law permits the exercise of business judgment involved in this case. See 615 F. 2d at 781-82. Petitioners' assertion to the contrary (Petition at 6, n.) ignores the clear authority of *Findley v. Garrett*, 109 Cal. App. 2d 166, 240 P. 2d 421 (1952), which was analyzed and properly relied on below.

2. There Is No Conflict Between Lewis and Existing Supreme Court Authority.

Petitioners assert that the Ninth Circuit's decision is in conflict with *J. I. Case v. Borak*, 377 U.S. 426 (1964), and *Superintendent v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), in its application of *Burks v. Lasker*. Disney respectfully submits that there is no such conflict.

The reference to *Borak* cited by petitioners from *Burks* (Petition at 10) is taken from the section of *Burks* discussing whether a private right of action should be recognized. The citation does not concern the underlying policy of § 14, as petitioners suggest.

Furthermore, the assertion of petitioners that the decision in *Lewis* creates an impediment to the enforcement of § 14, in contravention to the alleged approval of *Borak* in *Burks*, and the strong regulatory policy of § 14, is misplaced. The exercise of business judgment to dismiss a shareholders derivative action, in those states where business judgment may be so exercised under state corporate law, is not an impediment to the enforcement of § 14. It is merely an allocation of authority within the corporation over a cause of action which belongs to the corporation, provided a court finds that the authority was exercised independently and in good faith. It does not in any way detract from the ability of an individual plaintiff to assert an individual or class action claim for violations of § 14 in an appropriate case, and in no way bars the enforcement of § 14 by the Securities and Exchange Commission.

In *Maldonado*, Judge Weinfeld reached the same conclusion:

> "Plaintiff's argument also implies incorrectly that derivative actions are the sole private means of redressing violations of section 14(a) and enforcing the Congressional policy of protecting investors. The cause of action implied under section 14(a), however, can

> also be asserted by an individual shareholder in his own behalf or as a class action on behalf of all affected shareholders and therefore the business judgment rule cannot be said to preclude private enforcement of the proxy rules. Moreover, as the Supreme Court made clear in the *Borak* case, the basis for permitting an action under section 14(a) to be brought derivatively was that violations may injure the corporation as a whole. Thus, the effect of applying the business judgment rule is not to curtail enforcement of federally created rights but merely to provide that where such rights inure to the corporation they are to be exercised by the body to whom state law allocates the power and duty to press those rights — initially to the directors of the corporation and secondarily to the shareholders where the whole board is disqualified. If this derivative claim is not pursued, plaintiff is free to assert his independent claim in an appropriate action." *Maldonado v. Flynn, supra,* 485 F. Supp. at 281-82 (footnotes omitted).

Further, the extremely broad reading given *Borak* by petitioners is questionable in light of the subsequent rulings of this Court in *Touche Ross & Company v. Reddington,* 442 U.S. 560, 576-78 (1979) and *Transamerica Corp. v. Lewis,* 444 U.S. 11, 15-16 (1979), questioning the continuing validity of the *Borak* analysis.[4]

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[4]As this Court noted in *Touche Ross,* the "remedial purposes" of the Securities Exchange Act of 1934 are not sufficiently strong to justify reading the statutory provisions more broadly than the language and the statutory scheme reasonably permit. 442 U.S. at 578. *Borak* may not be relied on, as petitioners seek to do, to reflect an overriding federal policy which would preclude the exercise of business judgment by disinterested directors. In concluding that *Borak* did not support the implication of a private right of action under § 17(a) of the Securities Exchange Act, Mr. Justice Rehnquist stated for the Court:

> "To the extent our analysis in today's decision differs from that of the Court in *Borak,* it suffices to say that in a series of cases since *Borak* we have adhered to a stricter standard for the implication of private causes of action, and we follow that stricter standard today." 442 U.S. at 578.

Petitioners similarly overlook the especially strong federal policy involved in the Investment Company Act which this Court dealt with, and held permitted directorial dismissal of shareholder derivative actions, in *Burks*.[5] That Act was adopted because the other federal securities laws applicable to investment companies, including the Securities Exchange Act of 1934, were deemed by Congress to be inadequate. *See* House Committee on Interstate and Foreign Commerce, Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 9 (1966). Petitioners also fail to assert any reason for their claim that uniformity of enforcement, even were it affected by the ability of corporations in certain states to dismiss derivative suits, is more important in the Securities Exchange Act than it is in the Investment Company Act.

Petitioners' argument under § 10 is governed by the same analysis as their argument under § 14(a). The exercise by independent directors of business judgment does not bar enforcement of any of the securities laws or the rules of the Securities and Exchange Commission; rather, it allows the corporation, whose interests petitioners here assert that they seek to protect, to decide when it will seek to enforce a private claim which it may have under those laws, or others. This reasonable allocation of authority, consistent with the

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[5]Petitioners ignore other aspects of *Burks*, including the fact that the Investment Company Act, in § 20, has a provision directly comparable to § 14a. *See Maldonado v. Flynn, supra*, 485 F. Supp. at 281. In fact, the SEC's rules under § 20 of the Investment Company Act incorporate the SEC's proxy rules under § 14.

Further, it is clear that "when Congress did intend to prevent board action from cutting off derivative suits, it said so expressly." 441 U.S. at 484. *Compare* § 16(b) of the Securities Exchange Act, 15 U.S.C. § 78p(b) *with* § 14 of that Act, 15 U.S.C. § 78n.

good faith action of the corporation's board, is in no way a bar to enforcement.[6]

The decision below does not in any way conflict with *Bankers Life*. In that case, this Court stressed the need for relief to be available to defrauded corporations. That principle, however, does not mandate that an independent committee of a corporation's board may not determine, in the exercise of its business judgment, not to pursue that corporation's claims.

3. This Case Is at an Interlocutory Stage, and Thus, Intervention by This Court Is Neither Necessary Nor Appropriate.

Petitioners fail to state a reason, other than their own perceptions of the importance of this case, why this Court should depart from its normal practice of denying petitions for certiorari in cases involving interlocutory appeals.

Further, the issue presented herein is not one which must be decided without the benefit of full action by the lower courts. *See, e.g., Brotherhood of Locomotive Firemen v. Bangor & Aroostok R.R.*, 389 U.S. 327, 328 (1967); *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 584-85 (1952); *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916); *American Constr. Co. v. Jacksonville, T & K. W. Ry. Co.*, 148 U.S. 372, 384 (1893).

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[6]Petitioners assert in their statement of the case (Petition at 5) that the Special Litigation Committee's decision was undertaken "irrespective of the merits." A cursory examination of the opinion of the Ninth Circuit indicates that the Ninth Circuit reviewed the extensive activities of the Special Litigation Committee, many of which are set out in the opinion. That review showed that the decision of the Special Litigation Committee was made after a thorough legal and factual investigation. *See Lewis, supra*, 615 F. 2d at 780.

The court below remanded the case to the trial court for the reserved trial limited to the sole issues of the good faith and independence of the members of the Special Litigation Committee. Following that trial, a final judgment of dismissal may then be entered. The circumstances which then exist — which may or may not be different from the current circumstances — should appropriately determine whether the ultimate decision should be reviewed.

Conclusion.

For the reasons stated herein, respondent Walt Disney Productions submits that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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